

ANIEL E. LUNGREN
Attorney General

State of California
DEPARTMENT OF JUSTICE



1300 I STREET, SUITE 125
P.O. BOX 944255
SACRAMENTO, CA 94244-2550
(916) 443-8333

July 9, 1997

FACSIMILE: (916) 327-2319
(916) 327-7880

Lester Snow, Executive Director
CALFED Bay-Delta Program

Mike Madigan, Chairman
Bay-Delta Advisory Council

RE: Additional Information Regarding Conflicts of Interest in Contracting

Dear Mr. Snow and Chairman Madigan:

This letter provides additional detail regarding conflicts of interest in contracting. I previously provided summaries of key provisions of California law governing conflicts of interest focusing specifically on those arising out of government contracts. It is clear from the number of inquiries I've received, however, that additional information may be needed. This letter, therefore, is a more detailed summary of the law governing conflicts of interest in contracts (California Government Code section 1090, et seq.).

**Overview of the Law Governing
Conflicts of Interest in Contracts
(Government Code Section 1090, et seq.)**

As I described in an April 15, 1997 letter, Government Code section 1090 prohibits a public official from making a contract in which he or she is financially interested. The California Supreme Court described the purpose of section 1090 to make certain that "... every public officer be guided solely by the public interest, rather than by personal interest, when dealing with contracts in an official capacity. Resulting in substantial forfeiture, this remedy provides public officials with strong incentive to avoid conflict-of-interest situations scrupulously." (Thomson v. Call (1985) 38 Cal.3d 633, 650.)

Section 1090 provides that an officer or employee may not make a contract in which he or she is financially interested. Any participation by an officer or an employee in the process by which such a contract is developed, negotiated and executed is a violation of section 1090. This prohibition applies to virtually

all state and local officers, employees and multimember bodies, whether elected or appointed. The law does provide a list of "remote interests" that trigger abstention for board members, but which do not prevent the board from making a contract. In addition, the law sets out a list of "non-interests" that, once disclosed, do not prevent an officer, employee or board member from participating in a contract.

Any contract made in violation of section 1090 is void and cannot be enforced. In addition, an official who commits a violation may be subject to criminal, civil and administrative sanctions.

A. Who is covered?

Virtually all board members, officers, employees and consultants are public officials within the meaning of section 1090. (Thomson v. Call, supra 38 Cal.3d 633; City Council v. McKinley (1978) 80 Cal.App.3d 204; People v. Vallergera (1977) 67 Cal.App.3d 847; 70 Ops.Cal.Atty.Gen. 271 (1987); 46 Ops.Cal.Atty.Gen. 74 (1965).) Section 1090 also applies to members of advisory bodies if they participate in the making of a contract through their advisory function. (Millbrae Assn. for Residential Survival v. City of Millbrae (1968) 262 Cal.App.2d 222.) It is a question of fact with all other public officials as to whether they were involved in the making of a contract.

B. What constitutes "participation in making a contract?"

Once one determines that a public official is involved, the next question is whether the contract was "made" in his or her official capacity. In Millbrae Assn. for Residential Survival v. City of Millbrae, supra, 262 Cal.App.2d 222, the court defined making of the contract to include preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications and solicitation for bids.

This, and similar cases, make it clear that the prohibition contained in section 1090 also applies to persons in advisory positions to contracting agencies. (Schaefer v. Berinstein (1956) 140 Cal.App.2d 278; City Council v. McKinley, supra, 80 Cal.App.3d 204.) This is because such individuals can influence the development of a contract during preliminary discussions, negotiations, etc., even though they have no actual power to execute the final contract.

Additionally, if an official is a member of a board or commission which executes the contract, he or she is conclusively presumed to be involved in the making of his or her agency's contracts. (Thomson v. Call, supra, 38 Cal.3d at 645, 649.)

This absolute prohibition applies regardless of whether the contract is found to be fair and equitable (Thomson v. Call, supra, 38 Cal.3d 633; People v. Sobel (1974) 40 Cal.App.3d 1046) or the official abstains from all participation in the decision (Fraser-Yamor Agency, Inc. v. County of Del Norte (1977) 68 Cal.App.3d 201).

C. What kind of financial interest is prohibited?

For section 1090 to apply, the public official must have a financial interest in the contract in question. Although "financial interest" is not specifically defined in the statute, the courts have interpreted this phrase liberally to include both direct and indirect financial interests in a contract. (Thomson v. Call, supra, 38 Cal.3d. 645.) Moody v. Shuffleton (1928) 203 Cal. 100 is cited as an example of an indirect financial interest. In Moody a county supervisor sold his business to his son in return for a promissory note secured by the business. Because the business helped to secure the value of the official's mortgage, a conflict existed when county printing contracts were awarded to the son.

Although some statutory exemptions may negate the full effect of section 1090, the following economic relationships generally constitute a financial interest:

- employee of a contracting party;
- attorney, agent or broker of a contracting party;
- supplier of services or goods to a contracting party;
- landlord or tenant of a contracting party; and
- officer or employee of a nonprofit corporation which is a contracting party.

D. At what point in time does a conflict arise?

In determining whether self-dealing has occurred in the making of public contracts, factors such as the date that the official assumed or resigned from office, the date the contract was executed and the duration of the contract are important.

For example, an official who has contracted in his or her private capacity with the government before the official is appointed does not violate the section, and the official may continue in his or her position as such contracting party for the duration of the contract. The official's appointment does not void the contract. (Beaudry v. Valdez (1867) 32 Cal. 269.) When the time

comes for the contract to be renegotiated, the official faces a new set of problems.

However, simply resigning a public post may not cure a conflict in all situations. Timing is everything. In Stigall v. City of Taft, supra, 58 Cal.2d 565, the court ruled that a public official may not resign from office at the last minute in order to take private advantage of a contract in whose formation the official had participated in his or her public capacity. In that case, a city councilmember owned a plumbing business which was awarded a plumbing subcontract in connection with construction of a city civic center. The official had taken part in the planning, preliminary discussions, compromises, drawing of plans and specifications, and solicitation of bids for the civic center project. The court held that this councilmember had participated in "making" of the contract within the meaning of section 1090, even though the official resigned from office before the contract was finally awarded. (See City Council v. McKinley, supra, 80 Cal.App.3d 204.)

E. Are there any exceptions to this provision?

The statute provides descriptions of remote interests which trigger abstention for board members but which do not prevent the board from making a contract (§1091) and noninterests that do not prevent an official from participating in the contract (§1091.5).

1. Remote Interests.

A public official who is a member of a public board or commission with only a "remote interest" in a contract will not be deemed to have an "interest" within the meaning of section 1090. "Remote" refers to the private interest an official has in a contract. The official's public interest either exists or it does not.

An official whose interest falls within a specified remote interest category must (1) disclose the official's interest to his or her agency, board, or body, and (2) have it noted in the official records of that body. An official who intentionally fails to disclose the existence of a remote interest before action is taken on the contract in question would violate section 1090 and may be subject to criminal prosecution. However, such a violation would not void the contract unless the private contracting party knew of the official's remote interest at the time of contracting. (Gov. Code §1091(d).)

When an official claims a remote interest, the board or agency may take action on the sale, purchase, or other contract involved if it acts in good faith and if the vote to authorize, approve, or ratify is sufficient without counting the vote or votes of those with remote interests.

Remote interests are carefully defined in the law. Some of the specified remote interests include:

Officer or employee of a nonprofit corporation. An officer or employee of a nonprofit corporation has only a remote interest in the contract, purchases, and sales of that corporation. (§1091(b)(1).)

Employee or agent of a private contracting party. An employee or agent of a private contracting party may have only a remote interest in its contracts when (1) the private party has 10 or more other employees and (2) the official/employee has been an employee or agent of that party for at least three years. (§1091(b)(2).)

Special contracts. An official who is an employee or agent of a contracting party has a remote interest in the contract if (1) the official is an officer in the local agency located in a county with a population of 400,000 or less; (2) the contract is competitively bid, and the contracting party is the lowest bidder; (3) the official must not hold a primary management position with the contracting party or hold any ownership interest in the contracting party and may not have directly participated in formulating the bid of the contracting party; and (4) the contracting party must have at least 10 other employees. (§1091(b)(3).)

Landlord or Tenant. A landlord or tenant of a contracting party has a remote interest in the contracts of that party. (§1091(b)(4).)

Attorney, Stockbroker, Insurance or Real Estate Broker/Agent. An attorney of a contracting party has only a remote interest in the contracts of his or her clients. (§1091(b)(6).) In addition, an owner, officer, employee, or agent of a firm which renders service to the contracting party in the capacity of stockbroker, insurance agent/broker, or real estate agent/broker has only a remote interest in the contracts of his or her clients so long as he or she receives no remuneration, consideration, or commission as a result of the contract.

Member of a Nonprofit Corporation Formed Under the Agricultural Code or Corporation Code. Members of nonprofit corporations formed under either the Agricultural Code or Corporations Code for the sole purpose of selling agricultural products or supplying water have remote interests. (§1091(b)(7).)

Employee of a Consulting, Engineering, or Architectural Firm. An engineer, geologist, or architect has a remote interest in a consulting, engineering, or architectural firm if he or she does not serve as an officer, director, or in a primary management capacity. (§1091(b)(11).)

2. Noninterests.

Section 1091.5 delineates situations which might technically create conflicts of interest under section 1090, but which the Legislature has decided are exempt from its operation. Unlike the remote interest exception, the interest which falls into one of these categories is treated as no interest at all, and holding such an interest does not require abstention and generally does not require disclosure.

Some of the noninterests identified in the law include:

Corporate Ownership and Income. An official has a noninterest in a business corporation in which he or she owns less than 3% of its shares, as long as the official's total annual income from dividends and stock dividends from the corporation amounts to less than five percent of his or her income and any other income he or she receives from the corporation also amounts to less than 5%. In other words, it is a three-part test, and the official who fails any of the three parts cannot qualify for the noninterest exemption with regard to that corporation. (§1091.5(a)(1).)

Public Services. An official has a noninterest in the receipt of public services provided by his or her agency or board so long as he or she receives them in the same manner as if he or she were not a public official. (§1091.5(a)(3).)

Unsalariated Members of Nonprofit Corporation. A noninterest exists when a public official is a nonsalaried member of a nonprofit corporation provided the official's interest is disclosed to the body or board at the time the contract is first considered and is noted in its official records. (§1091.5(a)(7).)

Noncompensated Officers of Tax Exempt Corporations. A noninterest exists when a public official is a noncompensated officer of a nonprofit, tax exempt corporation which, as a primary purpose, supports the functions of a public body or board, or to which the public body has a legal obligation to give particular consideration. Such interest, if any, must be noted in the official records of the public body. (§1091.5(a)(8).)

Lester Snow, Executive Director
July 9, 1997
Page 7

F. What are the consequences of violating section 1090?

A contract made in violation of section 1090 is void. In addition, any officer or person who is found guilty of willfully violating section 1090 is subject to civil and criminal fines and penalties. Additionally, such an individual is forever disqualified from holding any office in this state. (Gov. Code §1097.)

Recent court decisions underscore the adverse consequences of violating section 1090, to government bodies and individual decision-makers alike. In Thomson v. Call, supra, 38 Cal.3d 633, for example, a city councilmember had sold a parcel of land to a third party, who in turn re-sold the property to the city. Despite the fact that the councilmember had abstained from the council vote which authorized the latter sale and had acted throughout in good faith, the California Supreme Court concluded that he had violated section 1090. As a sanction, the Court required the forfeiture of the councilmember's entire sales price for the parcel--\$258,000. (38 Cal.3d at 646-652.) The Supreme Court reached this harsh result based on the perceived importance of strictly enforcing state conflict of interest laws such as section 1090.


In People v. Honig (1996) 48 Cal.App.4th 209, the State Superintendent of Public Instruction was found guilty of violating section 1090 by entering into official contracts in which he had a financial interest. Superintendent Honig was criminally convicted of this offense, and eventually was required to relinquish his public office as a result.

Conclusion

This letter summarizes key provisions of California law governing conflicts of interest in government contracts. Hopefully, it will provide general guidance to Bay Delta Advisory Council members. It is not an exhaustive discussion of this very complex body of law. If members have questions, they are encouraged to contact me.

Sincerely,

DANIEL E. LUNGREN
Attorney General


MARY J. SCOONOVER
Deputy Attorney General

cc: Ecosystem Roundtable

26